

**DETERMINANTS OF CORPORATE TAX AVOIDANCE: SURVEY ON INDONESIA’S PUBLIC LISTED COMPANY**

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**Abstract**

The aim of this study is to determine the cause that effects to tax avoidance on Indonesia’s Listed Company. Prior study shows that corporate governance and some of financial conditions may effect to the lower or higher tax avoidance. By Using sample on manufactured listed company, Sample selection is used by purposive sampling method. This results show that corporate governance that measured by audit committee, board of commissioner, independent commissioner, and institutional ownership have significant impact to tax avoidance. Financialaal conditios measured with return On Asset (ROA) has positive significant impact to tax avoidance.

**Keywords:** tax avoidance, profitability, corporate

**I. Introduction**

The United Nations Conference on Trade and Development (UNTAD) 2015 reports that multinational companies have a big share in undermining tax revenues in developing countries. According to the results study, developing countries lose more than \$ 100 M annually due to tax avoidance by multinational companies (MNEs). Tax avoidance also causes the financial sector lose up to \$ 300 M. Multinational companies (MNEs) on average contribute 10% to the revenue of developing countries. Especially for developing countries on the African Continent, the tax contribution of MNEs can reach 14% of state revenues. (World Investment Report, 2015)

**Figure 6. Government revenues contributed by foreign affiliates of MNEs**  
Share of government revenues, developing countries, reference year 2012



Sources: UNCTAD estimates, based on the ICTD Government Revenue Dataset; IMF GFS database; United Nation System of National Accounts; Eurostat; U.S. Bureau of Economic Analysis; ILO; literature review.  
Note: Details on data and methods contained in Annex I.

Tax avoidance done by shifting profits to tax-haven countries. The study also showed that at least 30% of MNEs used a special purpose entity (SPE) to divert their funds. Any 10% increase in profit transfer through the SPE will be followed by a 1% tax reduction on the corporate tax return.

Tax avoidance is commonly done by global companies with branches in various countries. One of the modes against tax avoidance is the payment of royalty management fees on intellectual property rights over logos and brands to the parent companies. Increased royalties will increase costs which ultimately reduce net income so that Corporate Income Tax also fell. If the tax treaty rate for royalty tax is only 10 percent and the corporate tax rate is 25 percent, then Indonesia loses 15 percent PPh. Increasing royalty payments to a parent company has the potential to reduce corporate income tax payable by the company. From the financial statements on the BEI, a consumer goods company must pay royalties to a holding company in the Netherlands from 5 to 8 percent from 2013-2015, which is up from 3.5 percent. If calculated, the turnover assumption of 2013-2015 of consumer goods is stagnant at Rp27 trillion, with royalty increase from 3.5 percent to 8 percent. This means there is a royalty increase of 4.5 percent multiplied by Rp27 trillion or approximately Rp1,225 trillion. Thus, the potential loss of Corporate Income in 2015 amounted to Rp1,215 trillion multiplied by 25 percent or approximately Rp303 billion. This according to the rule is legal but it is unfair if viewed from the tax side for the source country of income, because 8 percent of the product price paid by the people of Indonesia run to the royalty holding company.

Tax avoidance practice is a deliberate attempt by companies to reduce tax liabilities through legal or illegal strategies. This happens because the boundary between legal and illegal acts is unclear, the legality of the company's tax position is determined by the tax authority body. Thus, there is no clear distinction between tax avoidance without legal consequences and tax avoidance with legal (illegal) consequences. Hanlon and Heitzman (2010) describe the types of tax avoidance actions ranging from the legal tax avoidance to the tax-raising strategies to tax strategies such as tax shelters (illegal tax avoidance) or often termed tax shelters and classified as illegal tax avoidance. Agency theory assumes that tax avoidance is the firm's strategic choice defined by the employment contract (actual or implied) between shareholders and tax managers.

The results of research by Chen and Chu (2005) show that corporate tax avoidance strategy occurs for two reasons. First, managers must be reassured by ex-ante compensation for future ventures by reducing tax liabilities. Thus, the level of compensation is not tied to the managers' actual level of business. Secondly, the manager's effort to reduce the company's tax liability by neglecting the weak internal control system due to the lack of optimal corporate governance (Desai and Dharmapala (2006) and Desai et al. (2007) .Research conducted by (Lee, et.al , 2015) critically uses the tax avoidance accounting literature with an emphasis on tax avoidance theory as well as empirical proxies for tax avoidance. The agency theory should be one of the relevant analytical bases to improve understanding of the interaction between managers and shareholders with respect to corporate tax avoidance strategies A number of empirical proxies for corporate tax avoidance are calculated using financial statement variables. The results of this study can not be generalized because their relevance is limited to firms involved in tax avoidance practices that

do by reducing the value of the book u and taxable income (reduce both book and taxable income). The existence of tax shelters and uncertain tax benefits can be used as a proxy for aggressive tax avoidance.

Research on the factors that cause of the tax avoidance has done by Gupta and Newberry, 1997; Rego, 2003; Phillips, 2003; Desai, 2007, Dyreng et al., 2008; Armstrong et al., 2012 which examines the firm characteristic relationship to tax avoidance, and from individual executive characteristics (Dyreng et al., 2010). TA to audit committee's expertise, Corporate governance to tax avoidance (Desai and Dharmapala, 2006, Desai, 2007). The conclusion of the research shows that due to the weakness of corporate governance, the company conducts tax shelters that are allegedly able to reduce costs and aggravate the internal control system. Tax avoidance measures can be performed with 5 (five) proxies: cash effective tax rate, total book-tax differences, permanent book-tax differences, discretionary permanent book-tax differences, and reportable transactions (Lisowsky et al., 2013 ).

Tax avoidance practices can also affected by other things, such as financial characteristics and corporate governance. Financial politics can be seen through the profitability and leverage of the company. Profitability of the company shown through Return on Assets (ROA) that reflects the company's performance. Through ROA can be seen the ability of the company in utilizing its assets efficiently in generating corporate profits. The company's earnings are the basis for taxation of the company. Leverage is a ratio that shows the amount of debt composition of a company. In general, companies use debt to third parties in running the company's operations. The addition of a debt of a company will result in interest expense which will be deducted from corporate tax burden (Kurniasih and Sari, 2013).

Tax aggressiveness is an act of corporate tax planning in effort to decrease the taxable income of a company either by legal or illegal way. The tax aggressiveness is often referred as tax sheltering or tax avoidance (Ridha and Martani, 2014). Some researchers such as Huseynov and Klamm (2011), Lanis and Richardson (2012), use the Effective Tax Rate (ETR) as a tax aggressive proxy. The research on corporate governance influence on tax avoidance done by Pradipta and Supriadi (2015) found that corporate governance as measured by independent commissioner dimension has no significant effect on tax avoidance. Other studies connecting corporate governance dimensions were conducted by Desai and Dharmapala (2006); Robinson et.al. (2012); Rego and Wilson (2012); and Armstrong et.al. 2013. The conclusion of the research is inconsistent with regard to the influence of corporate governance. The research by Armstrong et.al (2013) support the findings of Desai and Dharmapala (2006) that corporate governance as measured by CEO's Equity risks-taking is able to influence the level of tax avoidance measures. Minnick and Noga (2010) found that there was a positive influence of corporate governance (CG) using some proxy from CG finding positive results of CG influence on tax avoidance. Desai and Dharmapala (2006) found that companies with poor corporate governance (Poorly governance), whose managers have high incentives seek to reduce tax avoidance (TA).

Some previous research results on the impact of corporate governance and corporate profitability find inconsistency results on tax avoidance practices that make researchers will re-examine by using a more complete corporate governance proxy from previous research. Measurement of profitability by using Return On Assets (ROA) and Leverage company. As well as expanding the

proxy of corporate governance in accordance with research suggestions from Pradipta and Supriadi (2015) to provide a more comprehensive picture of the influence of corporate governance, the researcher puts the title: The influence of corporate governance and corporate profitability on tax avoidance practices.

## **II. Literature Review**

Jensen & Meckling (1976) defines agency as a relationship as a contract, whereby one or more persons (the employer or principal) hire another agent to execute a number of services and delegate authority to make decisions to the agent. Principal provides facilities and funds for the operations of the company, the agent is obliged to manage the company with the aim of improving the prosperity of the company owner. The agency theory is the basic theory that underlies the company's business that is used for this. The main principle of this theory states the existence of a working relationship between the party that gives authority (principal) ie investors with the party who receives the authority (agency) that is manager. This "economic interest" difference causes the emergence of asymmetric information between shareholders (majority & minority shareholders) on both parties. Agency theory assumes that all individuals act on their own behalf.

### **2.1. Corporate Governance**

Siswanto and Aldrige (2005: 2) define corporate governance as follows:

*“corporate governance is the system by which business corporation are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participant in corporation, such as the board, the managers, shareholders and other stakeholders and spells out of the rules and procedures and for making decision on corporate affairs. By doing this, it also provides the structure through which the company objectives are set, and the means of attaining those objectives and monitoring performance.”*

Corporate Governance is defined as a system to direct and control the company (Wahyudin Zarkasyi (2008: 36). Corporate Governance is a system (input, process and output) and a set of rules governing relations between various stakeholders especially in narrow relationships between shareholders, board of commissioners, and the board of directors for the achievement of corporate objectives. Corporate governance regulates the sharing of duties, rights and obligations of those concerned with the life of the company, including shareholders, boards, managers and all non stakeholder stakeholders. Corporate governance also prescribes the rules and procedures that the board of directors and board of directors must take in decision-making, the company has a handle on how to set corporate goals and strategies to prevent them. The division of duties, rights and obligations above also serves as a guide on how to evaluate the performance of board of directors and company management. The implementation of corporate governance in the company is expected to minimize agency problems, because in terms of definition corporate governance is a way of corporate management (the directors) responsible to

the owners of companies or shareholders (Organizational for Economic Co-Operation and Development / OECD, 2005. Definitions of Corporate Governance by (The Cadbury Committee / UK Dec, 1992) is "Corporate Governance is the system by which companies are directed and controlled". That is, corporate governance is a system used to direct and manage corporate activities. The system has a major influence in determining business goals and in an effort to achieve those goals. Corporate governance also has an influence in the effort to mencapai optimal business performance and in the analysis and control of business risks faced by the company.

Furthermore, according to the Forum for Corporate Governance in Indonesia (FCGI) the definition of Corporate Governance is a set of arrangements governing relationships between shareholders, managers of companies, creditors, government, employees, rights and obligations, or in other words a system that controls the company. The OECD states that good corporate governance is a way of corporate management (the directors) responsible to the owners of the company or shareholders. The objective of good corporate governance as stated in OECD (1999: 34) is to (1) to reduce the gap between the parties having an interest in a company (majority shareholder and other holders), (2) increase trust for investors in investments, (3) reduce the cost of capital, (4) convince all parties of the legal commitment in the management of the company and (5) the creation of value for the company including the relationship between stakeholders (creditor, investor, employee, bondholders and shareholders).

## **2.2. Corporate governance in SOEs**

Corporate governance is a set of relationships between management, directors, boards of commissioners, shareholders and other stakeholders governing and directing company activities (OECD, 1999). Corporate Governance (CG) is needed to maintain the viability of the company through management based on the principles of transparency, accountability, responsibility, independence and fairness.

In Indonesia, the implementation of Good Corporate Governance has been guided by the National Committee on Governance Policy (KNKG) through his new book released in 2006 entitled "General Guidelines of Good Corporate Governance Indonesia". The 2000 Regulatory and Regulatory Device which regulates and formulates the development of good corporate governance practices within the company, is then enhanced by KEP-117 / M-MBU / 2002 on the Implementation of Good Corporate Governance Practices (GCG) in SOEs and has been updated by Regulation Minister of State Owned Enterprises Number: PER-01 / MBU / 2011, dated 01 August 2011. With this decision, SOEs are required to apply the principles of corporate governance and must make measurements on the implementation of CG through assessment and review. Corporate governance is a process and structure used by SOEs to improve business success and corporate accountability in order to realizing shareholder value in the long run while maintaining the interests of other stakeholders, based on legislation and ethical values. The hope is to improve the performance of SOEs and implement CG principles more optimally. Therefore, directors, commissioners and audit committee are obliged to implement as a component of corporate governance can be stipulated by applicable regulation. Understanding or implementation Corporate Governance on SOEs can be seen from the system of mechanisms how the owner of the company affect the company manager.

### **2.3. Profitability**

Profitability is a description of the company's ability to generate profits that reflect the performance of a company. Richardson and Lanis (2007) stated that the greater the income earned by the company will affect the amount of income tax to be paid. Company profitability can be measured by using Return on Asset (ROA) ratio. The higher the ROA value shows the company's better performance (Kurniasih and Sari, 2013). This means that management is increasingly effective in utilizing company assets to generate profits.

### **2.4. Tax Avoidance**

Tax management efforts undertaken by the taxpayer to minimize the tax burden can be done through tax avoidance and tax avoidance. The category of tax avoidance is a legal tax management action because it uses more "loopholes" in the existing tax laws in Indonesia. The absence of a clear reference to tax avoidance between legal and illegal makes this very common for companies to do. (Santoso and Ning, 2013; 5). The definitions of tax avoidance by Robert H. Anderson is a way to reduce taxes that are still within the limits and can be justified, especially through tax planning. Tax avoidance may pose a risk to a company such as a fine or loss of a company's reputation. This may occur if the tax avoidance measures have violated or exceeded the limits of the tax provisions which then fall into tax avoidance. Tax avoidance is a business that leads to a criminal act in the field of taxation illegally and is outside the frame of the provisions of taxation (unlawfull) (Santoso and Ning, 2013: 21). So it can be clearly distinguished between the practice of tax avoidance and tax avoidance. A good tax planning is required for the tax burden borne by the taxpayer. The actions or efforts of the company to conduct tax avoidance efforts indicate the degree of aggressiveness to the tax. The greater the company's efforts to avoid taxes then the company is increasingly aggressive against taxes. Tax avoidance is an effective tax planning, which is to minimize / reduce the tax burden through a scheme / transaction that is clearly defined in the tax laws and the nature does not cause a dispute between the taxpayer with the tax authority because it utilizes the loophole of tax provisions a country (Rego, 2003; Darussalam and Septriadi, 2009; Dyreng et al., 2008; 2010; Hanlon and Heitzman, 2010). In Indonesia, there are only two taxpayer steps in reducing the tax due or tax payable, namely tax avoidance and tax avoidance (Santoso and Rahayu, 2013). Darussalam and Septriadi (2009) define the tax avoidance is a tax-deductible scheme by violating taxation (illegal) provisions such as by not reporting some sales or minimizing costs in a fictitious way. In many other countries there has been a tax avoidance scheme arrangement that includes acceptable tax avoidance and unacceptable tax avoidance. Unacceptable tax avoidance can also be categorized as aggressive tax planning (Dyreng et al., 2008; Frank et al., 2009). In Indonesia there is no law that provides clear definition of acceptable tax avoidance and unacceptable tax avoidance, so in practice there is often a different interpretation between taxpayers and tax officials (Darussalam and Septriadi, 2009).

### **2.5 The hypotheses Testing**

### **Effect of Corporate Governance on Tax Avoidance**

Corporate governance is a system that oversees the company to avoid the problem of agency conflict. Company supervision is conducted through the establishment of a board of commissioners consisting of independent commissioners. In carrying out its duties, the independent commission monitors management in order to make decisions or strategies of the company in good faith to the applicable provisions. Research conducted by Prakosa (2014), Pradipta and Supriadi (2015) shows that independent commissioners as one of the proxy of corporate governance measurement negatively affect the tax avoidance. This shows that the presence of an independent commissioner is able to reduce tax avoidance measures. Independent commissioners have conducted supervision to supervise the management in formulating strategies including in tax-related strategies. The corporate governance oversight mechanism allows limiting tax avoidance measures by companies (Taylor and Ricradson, 2013). Similarly, Richardson et al (2013) suggests that more independent corporate governance mechanisms can reduce the aggressiveness of corporate taxes. In contrast to these findings, some researchers found a strong influence of corporate governance implementation on tax avoidance. Research conclusions by Armstrong et al (2013) supporting the findings of Desai and Dharmapala (2006) that corporate governance as measured by CEO's Equity risks-taking is able to influence the level of tax avoidance measures. Minnick and Noga (2010) find there is a positive influence of corporate governance (CG) by using some proxy from CG found a positive result of CG influence on tax avoidance. Desai and Dharmapala (2006) found companies with poor corporate governance (Poorly governance), whose managers have high incentives seek to reduce tax avoidance (TA).

*H1: Corporate governance has positive impact to tax avoidance*

### **2.6. Profitability effects tax avoidance**

ROA (Return on Asset) is one of the corporate profitability measurement. ROA is getting bigger then the company earnings obtained become big too. As the company's profits increase, the tax burden the company pays increases as the company's profits increase. Richardson and Lanis (2007) stated that the greater the income earned by the company will affect the amount of income tax to be paid. Darmawan and Sukartha (2014) in his research showed that ROA has a positive effect on tax avoidance. This is because the company can manage its assets well so as to benefit from tax incentives and other tax breaks so the company looks to avoid taxes.

The same results were also shown by Chiou et al (2012), Kurnasih and Sari (2013). Research conducted by Richradson and Lanis (2007); Noor (2010); and Prakosa (2014) show that ROA negatively affects the effective tax rate. It shows that efficient and more profitable companies have lower effective tax rates because they can use their resources to benefit from tax incentives and manage good tax planning (Fatharani, 2012). Companies with high profitability indicate that companies have good tax planning so as to obtain an optimal tax, it results in the tendency of companies to do tax avoidance will decrease (Prakosa, 2014), Pradipta and Supriadi (2015).

*H2: Profitability has positive effects to tax avoidance*

**III. Research Methodology**

The pollution of this research is plantation companies, pulp & paper, plastic and chemical sub sector manufacturing company listed on Indonesia Stock Exchange during period of 2013 - 2015. Sample selection is used by purposive sampling method with following sample criteria : (1) Companies listed in Indonesia Stock Exchange during 2013-2015, (2) Companies that report complete financial statements, (3) The Company did not suffer any losses during the study period.

Tax avoidance measured by *Effective Tax Rate* (ETR) by Lanis and Richardson (2013). Corporate governance measured with audit committee, board of commissioners, independent commissioners, and institutional ownership. Profitability measured with return on assets (ROA). Hypothesis testing is done by multiple regression analysis with SPSS version 22 The hypothesis testing equation model is:

$$Y = \alpha + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \beta_4X_4 + \beta_5X_5 + \epsilon$$

Descriptions : Y = *tax avoidance*;  $\alpha$  = Konstanta  $\beta_1, \beta_2, \beta_3, \beta_4$  ; X1 = Audit committee; X2 = Board of commissioners; X3 = Independent commissioners; X4 = Institutional ownership; X5 = Profitability(ROA);  $\epsilon$  = Error

**IV. Results, Analysis, and Discussions**

**Tabel 4.1 Descriptive Statistics**

Descriptive Statistics					
	N	Minimum	Maximum	Mean	Std. Deviation
Audit Committee	39	,33	1,00	,6503	,24260
Board of Commissioner	39	2,00	8,00	4,0513	1,73127
Independent Commissioner	39	,33	,67	,4110	,09075
Ownership Institutional	39	,02	,88	,6538	,22548
Profitability	39	,01	1,21	,3513	,43389
Tax_Avoid	39	,03	,55	,2795	,10511
Valid N (listwise)	39				

**Table 4.2**

**One-Sample Kolmogorov-Smirnov Test**

		Unstandardized Residual
N		39
Normal Parameters <sup>a,b</sup>	Mean	,0000000
	Std. Deviation	,08168309



Most Extreme Differences	Absolute Positive	,126
	Negative	,126
Test Statistic		-,084
Asymp. Sig. (2-tailed)		,126
		,123 <sup>c</sup>

Sumber : Hasil pengolahan data menggunakan SPSS versi 22

- a. Test distribution is Normal.
- b. Calculated from data.
- c. Lilliefors Significance Correction.

Normality test results above shows that the existing variable is normally distributed because it has a significance of  $\geq 0.05$  is equal to 0.123 which means that every variable under study is normally distributed.

**Table 4.3**

**Model Summary<sup>b</sup>**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	,629 <sup>a</sup>	,396	,305	,08765	1,143

a. Predictors: (Constant), Profitabilitas, Komisaris\_Indep, Komite\_Audit, Kepemilikan\_Institusi, Dewan\_Komisaris

b. Dependent Variable: Tax\_Avoid

Based on the calculation in Table 4.3, the Dw is at 1.143. While from table Dw with significance 0,05 and amount of data (n) = 39, and K = 6 (number of independent variable) obtained value DL = 1,1042 and DU = 1,9315. So the Dw value is on DL <DW <DU (1,1042 <1,143 <1,9315) meaning there is no autocorrelation.

**Table 4.4**

**Coefficients<sup>a</sup>**

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
1	(Constant)	-,062	,104		-,591	,559		
	Audit Committee	-,068	,065	-,156	-1,041	,305	,815	1,228
	Board of Commissioner	,026	,010	,423	2,610	,014	,697	1,434
	Independent Commissioner	,217	,179	,187	1,214	,233	,769	1,300

Ownership	,246	,073	,528	3,354	,002	,739	1,352
Institutional							
Profitability	,089	,040	,366	2,220	,033	,672	1,487

The conclusion of this research Corporate governance and profitability to tax avoidance in plantation companies and manufacturing pulp & paper, plastic and chemical sub-sector from 2013 to 2015, the following conclusions are obtained:

1. Corporate Governance that measured with Audit Committee variable, Independent Commissioner has no effect on Tax Avoidance. While the variables of Board of Commissioners, Ownership Institutional positive effect on Tax Avoidance.
2. Profitability of companies proxied using ROA has a significant effect on tax avoidance.

**Discussions**

This research confirmed to research by Minnick and Noga (2010) that found there is a positive influence of corporate governance (CG) by using some proxy from CG found a positive result of CG influence on tax avoidance. Desai and Dharmapala (2006) found companies with poor corporate governance (Poorly governance), whose managers have high incentives seek to reduce tax avoidance (TA). This research can be expected to be a reference for further research in the same field. For further research, it is expected to add other variables in corporate governance such as audit quality, corporate secretary. Future research is expected to be developed and improved for example by extending the observation period and extending the sample. Further research is suggested to use Book Tax Difference as tax avoidance proxy, because it can be more detail in measuring tax avoidance.

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